# TRANSCRIPT OF PROCEEDINGS

In the Matter of: )
)
FEDERAL HOUSING FINANCE BOARD )
)
)
OPEN MEETING )

Pages: 1 through 89

Place: Washington, D.C.


## HERITAGE REPORTING CORPORATION

*Official Reporters*
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# TRANSCRIPT OF PROCEEDINGS

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Date: May 8, 2002

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# A G E N D A  I T E M S

1. APPOINTMENT OF PUBLIC INTEREST DIRECTOR
OFFICE OF THE BOARD OF DIRECTORS

The Finance Board will consider a replacement for one of the public interest director appointments for the FHLBank of San Francisco.

2. FINAL RULE AMENDING THE DEFINITION OF "NON-MORTGAGE ASSETS" FOR PURPOSES OF THE LEVERAGE LIMIT REQUIREMENT OF SECTION 966.3 OF THE REGULATIONS
Charlotte Reid, Scott Smith

This rule would permit FHLBanks to count favorably all U.S. government-insured or guaranteed AMA loans in determining whether the FHLBank is subject to the 25-to-1 assets-to-capital leverage requirement, as opposed to the more restrictive 21-to-1 requirement that generally applies.

3. FEDERAL HOME LOAN BANK OF PITTSBURGH CAPITAL PLAN
Scott Smith, Thomas Joseph

Consideration of approval of the Federal Home Loan Bank of Pittsburgh's Capital Plan and related resolutions.

4. FEDERAL HOME LOAN BANK OF BOSTON CAPITAL PLAN
Scott Smith, Thomas Hearn

Consideration of approval of the Federal Home Loan Bank of Boston's Capital Plan and related resolutions.

The parties met, pursuant to the notice, at 2:00 p.m.

APPEARANCES:

JOHN T. KORSMO, CHAIRMAN
FEDERAL HOUSING FINANCE BOARD

FRANZ S. LEICHTER, BOARD DIRECTOR
ALLAN I. MENDELOWTIZ, BOARD DIRECTOR
J. TIMOTHY O'NEILL, BOARD DIRECTOR
JOHN C. WEICHER

STAFF:

JAMES L. BOTHWELL, MANAGING DIRECTOR
ARNOLD INTRATER, ACTING GENERAL COUNSEL
ELAINE L. BAKER, SECRETARY TO BOARD
NEIL R. CROWLEY
THOMAS HEARN
THOMAS E. JOSEPH
CHARLOTTE REID
SCOTT L. SMITH
AUSTIN KELLY

P R O C E E D I N G S

(2:00 p.m.)

CHAIRMAN KORSMO: The Meeting will now come to order.

I want to acknowledge service to the Federal Housing Finance Board above and beyond the call of duty. If we had a Purple Heart, we would award it today to Director Tim O'Neill, who had foot surgery yesterday and was able to make it here.

Tim has always demonstrated the ability to play hurt and we appreciate it very much.

To impose upon the other Directors, if I may, unless there is some serious objections, I have been asked if we could reverse the order of the Agenda because there are a couple of staff people who are involved in issues three and four and would not necessarily have sit through the longer debate that I think we can anticipate on the two Bank Capital Plans. I do not object to any particular order on the two Capital Plans.

But unless there is some serious objection, if you do not mind, why don't we just go and reverse the order here and take care of the Public Interest Director Appointment and the Final 11 percent Rule first.

Hearing none, I guess that you answered that you agree.

MOTION I

APPOINTMENT OF PUBLIC INTEREST DIRECTOR

OFFICE OF THE BOARD OF DIRECTORS

CHAIRMAN KORSMO: You recall that at our March Meeting, we appointed Charlene Gonzales Zettel to a two-year term as a Public Community Interest Director, excuse me, was it a two-year term or three years, I thought that was right, to the Board of the San Francisco Federal Home Loan Bank. Unfortunately, Ms. Zettel is a member of the California State Assembly. Under the California State Constitution, Assembly members are prohibited from serving in this capacity, even if uncompensated.

So she, unfortunately, has had to withdraw from serving. While I hope that she will make herself available for appointment again this fall, once her term in the Assembly ends, we have then, in the meantime, resolved that it is important to fill this very important slot.

So, the new appointee is going to be offered today. The nominee to be named is a gentleman named Scott C. Syphax. The proposal is that he be named to a two-year term on the Board of Directors of the Federal Home Loan Bank of San Francisco and that he also be nominated a Community Interest Director. Is there a motion to appoint Mr. Syphax?

DIRECTOR O'NEILL: Yes, Mr. Chairman.

CHAIRMAN KORSMO: There is a motion to appoint Mr.

Syphax. Are there any other nominees? Are there any other nominees? Hearing none other, I will -- hearing no other nominees, I will call on the Secretary to please call the roll on Mr. Syphax.

THE SECRETARY: On the motion before the Board to nominate Mr. Syphax, Chairman Korsmo, how do you vote?

CHAIRMAN KORSMO: If I do not split everybody's ears, I will vote: Aye.

THE SECRETARY: Director Leichter?

DIRECTOR LEICHTER: Aye.

THE SECRETARY: Director Mendelowitz?

DIRECTOR MENDELOWITZ: Aye.

THE SECRETARY: Director O'Neill?

DIRECTOR O'NEILL: Aye.

THE SECRETARY: Director Weicher?

DIRECTOR WEICHER: Aye.

CHAIRMAN KORSMO: The vote is 5-0. Mr. Syphax will be appointed to the Board of the San Francisco Bank. I know that everyone has had a chance to review his qualifications. He is an excellent candidate and I am delighted that we have chosen as a Board to make this appointment. Thank you very much.

MOTION II

FINAL RULE AMENDING THE DEFINITION OF NON-MORTGAGE

ASSETS FOR PURPOSES OF THE LEVERAGE LIMIT REQUIREMENT OF SECTION 966.3 OF THE REGULATIONS

CHAIRMAN KORSMO: The next item on our Agenda is the Final Rule on Amending the Definition of Non-Mortgage Assets for Purposes of the Leverage Limit Requirement of Section 966.3 of the Regulations.

Charlotte, are you, excuse me, I guess I should be calling on Jim Bothwell to introduce the rule.

MR. BOTHWELL: Thank you, Mr. Chairman, good afternoon. And good afternoon as well to Director O'Neill, Secretary Weicher, Director Leichter and Director Mendelowitz.

Mr. Chairman, as you noted, the next item on the Agenda is the Final Rule that would amend the definition of non-mortgage assets for the purposes of determining whether the Federal Home Loan Bank is subject to the 25-to-1 assets-to-capital leverage ratios.

As you said, Chairman Korsmo, I will ask Charlotte Reid of the General Counsel's office to test this Final Rule for your consideration.

MS. REID: Mr. Chairman and Members of the Board, the staff recommends the adoption of the Final Rule to amend Section 966.3(a)(2) of the Finance Board's regulations. In order to redefine what the definition of non-mortgage assets consists of in terms of the eligibility for the 25-to-1

leverage requirement, this Rule was proposed and published for Notice and Comment.

The Finance Board received four comments, all of which were favorable. Certain suggestions that are not really applicable, at this point, to the Rule and the staff has recommended that those changes not be adopted. The Rule sets forth, as proposed, the definition of non-mortgage assets, as set forth in the Financial Management Policy Section II.B.8 through II.B.11, as well as the list of qualifying assets under the AMA rule.

Basically, the Rule simply incorporates into one place all of those assets that have been listed in other places, so it clarifies the Rule, provides transparency and it simplifies, without any substantive change, what could be included in the calculation.

Are there any questions?

DIRECTOR O'NEILL: When the Capital Plans are implemented, this issue goes away. But because the Capital Plans -- still at least two, sometimes three years away from implementation, it is very good that we do this, so I will complement the staff and you, Mr. Chairman, for finally bringing this issue before us.

CHAIRMAN KORSMO: Any other questions of the staff? Comments? If not, could I have a motion to approve the final vote.

Director Mendelowitz, any discussion of the Motion? Hearing none, the Secretary will please call the roll on: The Final Rule Amending the Definition of Non-Mortgage Assets for Purposes of the Leverage Limit Requirement.

THE SECRETARY: On the Motion before the Board, Chairman Korsmo, how do you vote?

CHAIRMAN KORSMO: Aye.

THE SECRETARY: Director Leichter?

DIRECTOR LEICHTER: Aye.

THE SECRETARY: Director Mendelowitz?

DIRECTOR MENDELOWITZ: Aye.

THE SECRETARY: Director O'Neill?

DIRECTOR O'NEILL: Aye.

THE SECRETARY: Director Weicher?

DIRECTOR WEICHER: Aye.

CHAIRMAN KORSMO: The Motion is carried and the Final Rule is adopted.

MOTION III

FEDERAL HOME LOAN BANK OF PITTSBURGH CAPITAL PLAN

CHAIRMAN KORSMO: Well, we now turn to the Proposed Capital Plans for the Federal Home Loan Bank of Pittsburgh and the Federal Home Loan Bank of Boston. Today's action represents, I believe, a watershed for the Federal Housing Finance Board. It is the moment when the

Board fully embraces the statutory substance of the Gramm-Leach-Bliley Act of 1999.

Gramm-Leach-Bliley overwrote the last vestiges of the old Federal Home Loan Bank Board and more clearly defined the new safety and soundness regulator first created in 1989, under FIRREA, that being, of course, the Federal Housing Finance Board.

The primacy of safety and soundness has dictated this change. In a 1998 study, the General Accounting Office identified a serious problem with the System because the Finance Board, as a regulator, also carried out operational duties, engaged in promotion of the System, and coordinated many of the System's functions.

The GAO concluded and I quote: "In our view, some of the FHFB's activities may undermine its independence as a regulator."

Accordingly, Congress set out to ensure the independence of the 12 Federal Home Loan Banks, while clarifying and strengthening the Finance Board's distinct role as their safety and soundness regulator. The old Bank Board had substantial operational authority over Home Loan Banks. The Finance Board does not.

Today, we continue the process of completing that transformation. The approval of the Capital Plans, mandated by Gramm-Leach-Bliley, will mark the functional end of our

role in making business decisions for the 12 Banks. The language in the Act is clear and I quote: "The Board of Directors of each Federal Home Loan Bank shall submit for Finance Board approval a plan establishing and implementing the capital structure for such Banks that the Board of Directors determines is best suited for the condition and operation of the Bank and the interests of the members of the Bank."

The statute charges the individual Banks, not the Federal Housing Finance Board, with preparing a Capital Plan that best suits the conditions and operation of the Bank and the interests of its members. In crafting those plans, the Act also enumerated several choices for the Banks to use to raise capital. For example, as to a minimum investment, Gramm-Leach-Bliley states and, again, I quote: "Each Capital Structure Plan of a Federal Home Loan Banks will require each member of the Bank to maintain a minimum investment in the stock of the Bank, the amount of which shall be determined in the manner to be prescribed by the Boards of Directors of each Bank and to be included as part of the plan."

Gramm-Leach-Bliley goes on to specify that a "Bank may, in its discretion", choose to establish that minimum investment by a stock purchase, based on a percentage of the total assets of a member, or a stock purchase based on a

percentage of the activities between the Bank and the member, or any other provisions approved by the Finance Board. Gramm-Leach-Bliley allows these options. It does not require them. The Act only requires that the minimum stock investment be set at a level sufficient for the Bank to meet minimum capital requirements. There is no requirement that the minimum investment be tied to any particular formula or activity.

So we can expect variations in capital plans, as these Banks craft an individualized plan to meet the particular needs of its members. That is precisely what we have before us in the two Banks today - variations. It is clear that each Bank's Board of Directors is responsible for business strategy; and the Finance Board is to review and approve plans to ensure legality and safety and soundness.

In that regard, each Bank must comply with the Gramm-Leach-Bliley capital requirements. Our regulations prohibit a Bank from redeeming any stock, if the redemption would cause the Bank to have insufficient capital. Moreover, a Bank, under our regulations, also may deny redemption of stock should it foresee a need to maintain or build its capital level against future risks or activities.

Finance Board regulations also set rigorous standards for measuring market risks, credit risks and operations risks. In many ways, market risk is one of the

most difficult and most important risk components for a Bank to manage, and we are working closely with all the Banks to ensure that they improve their modeling capabilities to measure market risks, thus helping make certain that Banks prudently manage their balance sheets.

The Plans before us have been exhaustively reviewed by our staff and have been found to be in both instances safe, sound and legal - safe, sound and legal.

A couple of weeks ago, I was in Pittsburgh and flew back to Washington. When I got to the airport, the airline announced that there were thunderstorms in Washington, D.C., so we were undoubtedly going to be late on arrival. But, nevertheless, they got us all on the plane because they said: We are going to depart on time. So, of course, we all loaded onto the plane and pulled away from the gate; and we sat on the tarmac for an hour and half before we took off and came back to Washington, D.C.

Of course, the reason we did this was because FAA regulations measure an airline's performance as a percentage of on-time departures, defined as when they back up from the gate. So there is, to some extent, a perverse incentive to get us all loaded up, move us all out on the tarmac and, without the decency even to serve us beverages, to leave us sitting there until such time as we could arrive safely at our destination.

Well, I always thought this was a little lacking because it occurred to me what really counts isn't when you leave, it is when you arrive.

Today, we face a choice that measures what really counts in a Capital Plan. That choice can be framed with two simple questions:

> Shall we focus on whether a Bank has sufficient capital on hand at all times to meet the leverage and risk-based capital requirements, thus ensuring safety and soundness?
>
> Or, should we instead impose an arbitrary measure based not on how much capital is on hand but on how it is accumulated, thereby overruling in a sense the Bank's board with a business decision made around this table and running the risk of handcuffing the Bank's directors charged, by law, with continually monitoring and adjusting the capital accounts of the Bank?

But, fortunately, while returning from the Pittsburgh Bank visit, I was struck by just how risky a wrong decision by this Board can be. But, fortunately, the current statutory and regulatory regime for designing, approving, implementing and managing new, more permanent capital structures for each Bank plays to the strengths of the System and this Board.

The executives and directors of the 12 Banks know what they are doing. The members of each Bank, the Bank's owners really, give clear instructions to their leadership on the services and the returns that they expect.

The Finance Board is strong suit, if we stay the course, is to provide reliable policy direction and strong, tightly-focused supervision of safety and soundness.

If the Board strays into realms reserved by Gramm-Leach-Bliley to Banks, then I would argue, by common sense, to the owners and directors of the Banks that we run the risk of losing sight of safety and soundness as we struggle to exert daily business control over Bankers more expert than any one of us.

Let me try then to summarize exactly what in my mind is, and perhaps more importantly, what is not on the table today. First, the Seattle and Atlanta Capital Plans already approved, the Pittsburgh and Boston Plans before us today, and the eight plans to follow in June and July will each adhere to precisely the same standard of capital sufficiency. That sufficiency measure is laid out in Gramm-Leach-Bliley and in our own regulations. There have been and there will be no exceptions or dilutions. There has never been a rule in the System to impose uniform capital charges on Banking activities in proportion to the risks associated with those activities.

I know of no plan, proposed or approved, that sets a capital charge for taking an advance as low as the actual risk experience of that activity. Nor do I know of any plan, or any proposal, which would impose a capital charge on acquired member assets that reflects the real risk experience of that business.

Banks provide many services to their members. In no plan are all of those services tagged with a capital charge related directly to risk. Instead, charges are applied to only two or three of the services and are designed to raise all the capital needed by the Bank.

These are the choices provided by Gramm-Leach-Bliley, allowing the Banks to raise capital by assessing such things as membership, and/or advances, and/or AMA to meet their specific business needs. Whatever choice a Bank makes, the resulting capital sufficiency at the bottom of the page will be identical among all Banks - strictly adhering to the risk-based capital and leverage standards put in place by Congress and by this Board.

It is mistaken to assert that the System has a tradition that requires members to supply capital in proportion to any risk they place on a Bank's balance sheet. For 70 years, members have, from time to time, held capital in excess of their borrowing. That excess has always been used cooperatively to enhance safety and soundness and

increase dividends for all members. This Board unanimously reaffirmed that practice when we approved the Seattle and Atlanta Capital Plans.

Under the law and this Board's current regulatory scheme, all shares possess the same characteristics of permanence and leverage of their class, A or B. It makes no difference whether a share finds its way to a Bank's balance sheet as a membership requirement, an activity requirement, or as a stock dividend. If a Bank needs the capital, the shares are equally available for the safe operation of the Bank. Redemption and repurchase of any share, no matter how it was acquired by the member, is a qualified right. It may not be exercised if a Bank needs the capital to ensure safety and soundness, even if it is an activity share and the activity has ceased.

I recognize that a fundamental distinction exists between the business of making advances and the business of buying mortgages from members. An advance is a well-collateralized loan. The System knows that activity well. Not once in 70 years has there been a case where a member's stock and collateral failed to cover a default.

The AMA business is newer and must be watched closely by the Banks and by the Finance Boards. It is quite distinct from the advance business. First, it is an investment decision made by the Bank, not by the member

offering the loan for sale. As such, it is sensible to allow the Bank to decide how to raise capital to support its AMA investment, as is the case with any of its other permissible investments.

Second, the member selling the mortgages generally must provide a credit enhancement to protect the Bank from expected credit losses. The credit enhancement, itself, must also be collateralized. It is not possible to cancel or walk away from that credit-enhancement obligation, even if a member withdraws from a Bank.

Third, the risk-based capital standards adopted by this Board requires that sufficient capital be set aside to safeguard a Bank's portfolio of mortgages and the hedging of that portfolio. As I outlined in my April 23rd guidance memo to staff, I agree that AMA is a unique business and that, after experience and study, unique loss protections must be considered. But, so long as a Bank engaging in AMA activities complies with the capital sufficiency requirements of Gramm-Leach-Bliley and the Finance Board, I strongly disagree with the assertion that AMA must be arbitrarily taxed in response to some unspecified and, as yet, unidentified additional risk.

I apologize for the length of these opening remarks. I thoroughly expect that other Directors will also want to make remarks as we enter the discussion of the two

plans. But, with this statement on the record, let me now ask Jim Bothwell to outline the proposed Capital Plan for the Federal Home Loan Bank of Pittsburgh.

MR. BOTHWELL: Thank you, Mr. Chairman. The capital structure plan for the Federal Home Loan Bank of Pittsburgh involves three related resolutions. The first of these resolutions would approve the Bank's capital structure plan that is dated April 26, 2002, subject to its being ratified by the Bank's full board of directors. In accordance with the Finance Board's regulations, this resolution also requires Finance Board approvals of the Pittsburgh Bank's internal Market risk model and risk assessment procedures and controls before implementation can occur.

The second resolution would waive the six-month notice requirement for redemption of the Bank's existing stock, thus allowing the Bank to convert more quickly to its new permanent stock structure.

The third resolution, Mr. Chairman, specifies the provisions of the Finance Board's Financial Management Policy that the Bank would still be subject to upon implementation of its new permanent capital structure.

At this time, Mr. Chairman, I would like to ask Scott Smith, the Acting Director of the Policy Office, to please present the plan for the Board's consideration.

MR. SMITH: Thank you, Jim. Good afternoon, Mr. Chairman and Members of the Board. The staff is requesting that the Board of Directors consider and approve three resolutions, all of which are concerned with the constituted pool of the structure component of the Pittsburgh Federal Home Loan Bank's Capital Plan.

In response to staff comments, the Pittsburgh Plan has been revised several times since its submission. The Finance Board now finds that its most recent version of the plan, approved by the Executive Committee of the Bank's Board of Directors on April 26, 2002, complies with Finance Board regulations.

The Pittsburgh Plan is a straight-forward, all Class B stock plan. Since Class B stock plus retained earnings constitute permanent stock, as defined by Gramm-Leach-Bliley, all of the Bank stock will be eligible to meet risk-base capital requirements. And, in meeting the four percent leveraged capital requirement for unweighted stocks, the Bank will also meet the five percent weighted stock-leveraged requirement without question.

At this point in time, in going forward, Staff believes that the leverage requirement, rather than the risk-based capital requirement, will be the binding constraint on the Bank's minimum capital. Furthermore, staff finds that all features of the Plan are fairly

consistent with the concept of fairness to all members and with the cooperative nature of the Bank System.

If approved, the Bank intends to convert to the new capital structure in about 18 months or less. Implementation of the Plan will position the Bank with more permanent capital and will require that the Bank adopt a more state-of-the-art risk-management process. Otherwise, the Bank is expected to go forward with little or no change in its current business plan, but which does include increasing their AMA portfolio from about $1.5 billion to nearly $5 billion over the next several years.

Under the Plan, a member's total stock purchase requirements will equal the sum of its membership requirement and its activity-based requirements. The Plan requires that each member hold stock to meet the membership requirement set at .5 percent of a member's unused voting capacity or collateral available to support advances. The Plan allows the Bank to adjust its percentage between 0 and 1.5 percent and to also impose a cap of no less than $10 million.

Note that with this structure as the members' advances increase, their membership stock requirement will decrease. The plan also provides, however, that at no time will the membership requirement be less than $10,000.

Activity-Based stock purchase requirements apply

to each of two types of activities, with the stock purchase requirement for advances starting at 5 percent with the range of 4-1/2 to 6 percent; and the stock purchase requirement for AMA, starting at 0 percent and ranging from 0 to 4 percent. The Finance Board rule provides that the minimum stock purchase, or investment requirements, established by the capital plan, must be set at a level, which provides sufficient capital for the Bank to comply with its minimum capital requirements.

As part of the analysis, staff reviewed the material submitted by the Bank to support approval of the Plan, including: *pro forma* financial statements, the assumptions behind these statements, the management's estimates of the amount and type of stock that would be associated with the *pro forma* statements.

Staff's review also includes stress testing of the capital structure of the Bank as discussed in the Plan. The stress-test results did not reveal any obvious safety and soundness concerns. The staff's analysis of the Bank's projections indicate that the Bank will have sufficient capital at the moment of implementation and going forward, even under the stress scenarios examined.

The staff further notes that the Bank intends to repurchase all excess stock. Overall, given the activities and risk profile explicit in the *pro forma* financial

statements submitted by the Bank, and based on a review of the stress scenarios, staff believes that the Plan should allow the Bank to meet the leverage of the risk-based capital requirements under normal conditions than under those stressful conditions under which they were tested.

Thus, staff has not identified any impaired structural flaws or other problems in the Plan; and the initially proposed new investment requirements that would prevent the Bank from maintaining sufficient capital to comply with statutory and regulatory requirements and to continue to operate in a safe and sound manner.

I would be pleased to answer any questions.

CHAIRMAN KORSMO: Are there any questions for Dr. Smith?

Dr. Weicher?

DIRECTOR WEICHER: You mentioned a few moments ago that the plan passes the stress test for -- I think you said for the circumstances and situations that were analyzed. Is that an analysis by the staff for the variety of situations, or is that an analysis by the Pittsburgh Bank?

MR. SMITH: It's by the Bank for staff, scenarios we put to them.

DIRECTOR WEICHER: What sort of scenarios did you put together?

MR. SMITH: I would have to call one of the

analysts, specifically for those details. Austin?

DIRECTOR WEICHER: Sure.

MR. SMITH: Would you like me to do that?

MR. BOTHWELL: Just as a clarification. The Pittsburgh Bank also submitted different scenarios itself -- projections, ranging from vigorous business growth to a greatly stressed financial environment --

MR. KELLY: We examined different scenarios asset declines and increases -- but the stressful ones would be sharp declines in advances and spreads.

CHAIRMAN KORSMO: I am sorry. "Declines and", we can't quite hear you, Austin.

MR. KELLY: Okay. On declines in advances, there is a 15 to 20 percent per year over a three-year horizon, the most stressful declines in advances, it is coupled with half the AMA sales that they projected; declines in spreads earned about 50 percent. Those are the basic stress scenarios that we looked at.

DIRECTOR MENDELOWITZ: Anywhere, in this, is there something analogous to the depression scenario?

MR. KELLY: No. No. It doesn't go that far.

DIRECTOR MENDELOWITZ: What was the worst economic circumstance that you, or the FHLBank of Pittsburgh posted?

MR. KELLY: The most stressful decline in assets is about 15 percent a year, which is about what we saw in

Dallas around 1990. We decreased spreads by about 50 percent of course spreads could go as low as 0 for awhile but you would not expect that situation to remain on an ongoing basis. We are doing a longer run analysis.

DIRECTOR MENDELOWITZ: Thank you for the clarification. As I understand what you are saying: In your stress test, you don't start out assuming there is a depression and then try to work that through. What you do is: You assume certain changes in the business environment and come at it that way and you run those through the model.

MR. KELLY: I think we look at the balance sheet at certain items.

DIRECTOR MENDELOWITZ: Right.

MR. KELLY: -- and change those based on historical experience, what we have seen in the last ten or twenty years in stress conditions.

CHAIRMAN KORSMO: Any other questions? Seeing none and since there is no objection as we did with the previous plans, could we just consolidate the vote on all three resolutions?

Seeing no objection, does anyone move adoption of the capital structure plan resolution, the waiver of withdrawal notice requirement resolution, and the Financial Management Policy exemption resolution?

DIRECTOR O'NEILL: (Motioned)

CHAIRMAN KORSMO: Director O'Neill, have you moved the motion. Director Leichter?

DIRECTOR LEICHTER: I would like to say that we received and I think that every Board member has seen that the Board of Directors of the Pittsburgh Bank, through its Executive Committee, on May 6th, adopted a resolution that the Pittsburgh Bank will accede to us what is called the capital sufficiency test, a provision that is contained in both the Seattle and Atlanta plans; and which I think they put a prophylactic on, as a safeguard against an undue reliance on excess stock. I think it is a wise step that the Pittsburgh Bank has taken to be concerned with what Director Mendelowitz and I have expressed.

In view of this resolution of the Pittsburgh Bank, I feel comfortable with the Pittsburgh Plan and I want to express my appreciation to Jay Roy, the President of the Bank as well as David Curtis, both counsel, Dana Yealy and the Board of Directors of the Pittsburgh Bank for appreciating this Board and for having this provision in there.

I would like to make that part of the record of this Hearing, if we can, and I believe that ends the record. I will keep a copy of it, but I have a copy here.

CHAIRMAN KORSMO: Thank you. If there is no objection, I would like to approve the resolution without

any further discussion. (The official record of this --) Is there any other discussion of the Motion?

Good, good. Director Mendelowitz?

DIRECTOR MENDELOWITZ: Yes. My view is that when you do a safety and soundness assessment of a Capital Plan, you can't look at it as a stand-alone matter for consideration.

The Capital Plan, I believe, only has meaning within the context of a business plan of a Bank and the risk-management systems and procedures. Therefore, I reviewed this proposed plan in conjunction with the Bank's business plan and its basic risk management procedures and policies, as well as certain other Board-adopted policies that, including the resolution to which Director Leichter referred.

Based on that review, I believe we have a plan which meets my standards for safety and soundness. I am happy to lend my support to the approval of the Pittsburgh Bank's proposed Capital Plan.

CHAIRMAN KORSMO: Are there any other discussions of the Motion? Any other discussions? Seeing none, I will -- I am sorry. John, I am sorry.

DIRECTOR WEICHER: I didn't get my hand up in time. I just wanted to say that I think your remarks at the beginning, Mr. Chairman, were quite appropriate, directing

us to look at the purpose of having capital as opposed to the sources of having capital. Most of the discussion that I have seen of this plan, for example, what I have received, although this is a little overstating because in a couple of cases I think I have four copies of the same document from different sources. They all wanted to make sure that I read it.

I think most of this discussion is about where the capital is coming from. I think the basic concern that we need to have is what the capital is for. Our job is: to regulate the Banks; to protect the government and the taxpayer; and to worry about the safety and soundness of the Banks. We have broadly similar responsibilities to our sister financial regulatory agencies for the institutions that they regulate and we have that responsibility for these 12 Banks.

Because of that concern, I am most interested in the ability of these Banks to withstand the kinds of economic distress that we have occasionally experienced in the past; and that, most recently, we experienced in 1990 or thereabouts when, of course, in those travails, this body was created as a successor to the old Home Loan Bank Board and we learned that the 12 Home Loan Banks could survive a rather difficult situation -- could survive without, as you know, without losing anything, without having a single

default done on advance.

Since then, we have implemented new lines of activities being undertaken by some of the Banks. I think it is important for us to be sure that we have the best assurance that we can have that the Banks are in a position to withstand unexpected circumstances with those lines of business. I think we, as a Board, should be looking closely at the stress tests, the stress that we have, and looking closely at the results of the stress tests that the individual Banks perform. I hope that we be able to continue doing that as the other plans come in.

CHAIRMAN KORSMO: Any other discussion, if I promise not to be so hasty? Seeing none, the question is on: The approval of the three resolutions included in the Motion to approve the Federal Home Loan Bank of Pittsburgh's Capital Plan.

The Secretary will please call the roll.

THE SECRETARY: On the Motion before the Board, Chairman Korsmo, how do you vote?

CHAIRMAN KORSMO: Aye.

THE SECRETARY: Director O'Neill, how do you vote?

DIRECTOR O'NEILL: Aye.

THE SECRETARY: Director Weicher, how do you vote?

DIRECTOR WEICHER: Aye.

THE SECRETARY: Director Mendelowitz, how do you

vote?

DIRECTOR MENDELOWITZ: Aye.

THE SECRETARY: Director Leichter, how do you vote?

DIRECTOR LEICHTER: Aye.

CHAIRMAN KORSMO: The Motion is carried. The Capital Plan for the Federal Home Loan Bank of Pittsburgh is approved.

MOTION IV

FEDERAL HOME LOAN BANK OF BOSTON'S CAPITAL PLAN

CHAIRMAN KORSMO: The next item on our Agenda is the Capital Plan proposed by the Federal Home Loan Bank of Boston. Mr. Bothwell?

MR. BOTHWELL: Thank you, Mr. Chairman. The last item on today's Agenda is the capital structured plan of the Federal Home Loan Bank of Boston. It involves two, not three related resolutions.

The first of these two resolutions would approve the Boston Bank's capital structure plan, dated April 25, 2002, subject to an amendment that would place a continuing obligation on the Bank's board of directors to review and adjust, as necessary, the members' required stock investment to ensure that the Bank remains in compliance with its minimum regulatory capital requirement.

This resolution also requires Finance Board

approvals of the Boston Bank's internal market risk model and risk assessment procedures and controls before implementation can occur.

The second resolution, Mr. Chairman, specifies the provisions of the Finance Board's Financial Management Policy that the Boston Bank would still be subject to upon implementation of its new capital structure.

Again, I call upon Scott to present the Boston Bank's capital plan for Board's consideration.

MR. SMITH: Thank you, Jim. The staff is requesting that the Board of Directors consider and approve two resolutions, which are concerned with and constitute approval of the structure component of the Boston Federal Home Loan Bank's Capital Plan.

Because the plan has a six-month opt-out period, the Finance Board does not have to provide a waiver of the withdrawal notice requirement. In response to staff's comments, the Boston plan has been revised several times since its submission. The staff now finds that the most recent version of the plan, approved by the Bank's Board of Director on April 25, 2002, complies with Finance Board regulations subject to amendment of one section of the Plan to conform more closely with certain statutory and regulatory requirements.

President Jessee has stated in a letter to

Chairman Korsmo that, at the Bank's next regulatory scheduled meeting, the Board of Directors will amend Section IV.C.1 of the Capital Plan to state explicitly that the Bank's Board of Directors has a continuing obligation to ensure the Bank's compliance with its minimum regulatory capital requirements.

The Finance Board's approval of the Boston Plan is conditioned upon the Plan being amended. The Boston Plan is a straight-forward all Class B plan. It has Class B stock plus retained earnings, which constitutes permanent stock as defined by Gramm-Leach-Bliley, all the Bank stock will be eligible to meet the risk-based capital requirements. And in meeting the 4 percent leveraged capital requirement for weighted stock, the Bank will also meet the 5 percent weighted stock leveraged requirement without question.

At this point in time, in going forward, staff believes that the leveraged requirement rather than the risk-based capital requirement will be the binding constraint on the Bank's minimum capital.

Furthermore, staff finds that all features of the Plan appear to be consistent with the concept of fairness to all members and with the cooperative nature of the Bank's System. If approved, the Bank intends to convert to the new capital structure in 36 months or less. Implementation of the Plan will position the Bank with more permanent capital

and will require that the Bank adopt a more state-of-the-art risk management process. Otherwise, the Bank is expected to move forward with little or no change of its current business plans.

Under the Capital Plan, a member's Total Stock Investment Requirement will equal the sum of its membership requirement and its activity-based requirement. The Plan requires that each member hold stock to meet the membership requirement set at .35 percent of the member's Membership Stock Investment Base. The base includes single-family and multifamily mortgage loans and U.S. Government Agency securities and MBS.

The Plan allows the Bank to adjust this percentage to between 0.5 and .5 percent. The Plan also provides for a minimum membership investment of $10,000 and a cap of $25 million. The Plan allows the Bank to adjust the minimum investment between $5,000 and $50,000 and to adjust the cap between $5 million and $100 million.

The Activity-Based Stock Investment Requirement, which applies to AMA, advances, advance commitments, standby letters of credit and intermediate derivatives is set at 4.5 percent. However, there is a range of 0 to 6 percent for AMA and a different range of 3 percent to 6 percent for all other activity-based assets.

The Finance Board rules provide that the minimum stock purchase or investment requirements established by the Capital Plan must be set at a level, which provides sufficient capital for the Bank to comply with its minimum capital requirements.

As a part of this analysis, staff reviewed the materials submitted by the Bank to support approval of the Plan, including both *pro forma* financial statements, the assumptions behind these statements, and management's estimates of the amount and type of stock that would be associated with the *pro forma* statements.

Staff's review also included stress testing of the capital structure of the Bank as discussed in the plan. The stress test results did not reveal any obvious safety or soundness concerns. The staff's analysis of the Bank's projections indicate that the Bank will have sufficient capital at the moment of implementation and going forward, even under the stress scenarios examined.

Further, staff notes that the Bank intends to repurchase any excess stock that exceeds the members' Total Stock Purchasing Requirement by more than 5 percent. Overall, given the activities and risk profile implicit in the *pro forma* financial statements submitted by the Bank and based on review of the stress scenarios, the staff believes that the Plan should allow the Bank to meet the leveraged

and risk-based capital requirements under normal conditions and under the stressful conditions specifically tested.

Plus, the staff has not identified any apparent structural flaws or other problems in the Plan and the initial proposed minimum investment requirements that would prevent the Bank from maintaining sufficient capital to comply with statutory and regulatory requirements and to continue to operate in a safe and sound manner.

Once again, we would be pleased to answer any questions.

CHAIRMAN KORSMO: Are there any questions of the staff? Dr. Weicher?

DIRECTOR WEICHER: I have the same question that I had before on the Pittsburgh Bank about the nature of the stress tests?

MR. SMITH: It is the same test actually. We developed it to apply to all the Banks. So we would have some --

DIRECTOR WEICHER: Yes. Did the Boston Bank do anything different than the Pittsburgh did? Is Jim's comment that the Pittsburgh Bank did eight scenarios or something? Did the Boston Bank do a variety of scenarios as well?

MR. KELLY: I am sure they did. Yes. I don't know if it was eight or nine, but the Boston Bank also did

something in that neighborhood.

DIRECTOR WEICHER: Okay.

CHAIRMAN KORSMO: Any other questions? Any questions of the staff? Hearing none then, again, without objection, we would consider both resolutions in one Motion.

Is there a Motion to approve: The Capital Structure Plan of the Federal Home Loan Bank of Boston and also to approve the Financial Management Policy Exemption Resolution? Is there a Motion?

DIRECTOR WEICHER: Yes.

CHAIRMAN KORSMO: Dr. Weicher moves to the adoption of the two resolutions. Is there any discussion? Mr. Leichter?

DIRECTOR LEICHTER: Yes. I am constrained to oppose this most recent plan of the Boston Bank that is before us on the grounds of safety and soundness. I do not think it comports with the policy that was set forth by this Board in its capital regulations. I would urge that the plan, in its present form, be withdrawn; and I believe that it would not be difficult to make adjustments that, without question, would meet the safety and soundness standards that we think are appropriate, but would also be in accord with the policy that I think this Board has previously adopted. I think that we need to look at the history of this as it developed.

On January 18th, Mr. Chairman, you sent out a guidance to the staff on how it should treat capital plans. This was your guidance but it was ratified by this Board when we approved the Seattle Plan and the Atlanta Plan, which were unanimously approved. It is important to note that in both of these plans that there were certain safeguards, which the staff felt was appropriate in recommending that these plans be adopted. And that was one that they had a stock purchase requirement for AMA; and secondly, they imposed a capital sufficiency test to ensure that there was not undue reliance on excess stock to meet capital needs.

Now, the capital sufficiency test was something that this Board not only adopted but we did so with the understanding that we had two years to see whether this test was, in fact, required, needed, and also to see whether other adjustment were made.

But for us to decide at this point -- in accordance with your directives, Mr. Chairman, was that we ought to be extremely sure and certain that there was sufficient capital structure to maintain the activities of the Bank. Now eight Banks have submitted draft plans, which conformed with the action that this Board had taken, in ways that I took and understood was the policy that this Board

had adopted.

Included in these eight Banks was Pittsburgh, which did have a 0 to 2 percent range of AMA capital charges, but did have a capital sufficiency test. Boston had, at that time I believe, -- it made a six percent charge on AMA activities and had capital sufficiency tests.

Now, on April 23rd, we have another guideline that has been issued by you, Mr. Chairman. Certainly, it is perfectly appropriate for you to express your opinion and give guidance to the staff. But it was not the policy of the Board. It has never been acted on by the Board and was certainly at variance with what I would call Chairman I, which is the January 18th guidance. I will call April 23rd, Chairman II.

Whether intended or not, it was a dramatic change and led the Banks then to change their plans, including Pittsburgh and Boston. I advised you, Mr. Chairman, of my concerns and sent them by e-mail on April 24th, about the policy that seems to be set forth in your Chairman Guidance II.

Now, whether intended or not, Chairman Guidance II appears to accommodate the Chicago Capital Plan. If this is the model that is followed, as the revised Boston plan before us now does, it will redo the cooperative nature of the Home Loan Bank system, lead to greater risk being put on

the books of those Banks, which embrace this model, and lead to a capital structure that relies heavily on excess stock subject to redemption.

This model also undermines the principle which has guided the Home Loan Bank system since its inception: That there be a nexus between the stockholding and the assets that are put on the books of the Banks.

Boston initially had a plan, which had a capital sufficiency test and, therefore, was in accord with the general policies that we adopted and as reflected in our approval of the Seattle and Atlanta Plans. Now, Boston has changed its plan to provide for an AMA capital charge of 0 to 6, and those will initially start with a capital charge for AMA activities at 4.5 and advises that you can go to 0 on capital charge.

Boston repeatedly had a capital sufficiency test. Now there is no such test. I want to point out that these changes were all, as I was going to say, rushed through. But they were taken it seems very rapidly after Chairman II was issued. What we have as a consequence is that the Boston Plan does not satisfy what I consider safety and soundness standards. And I contend that it departs from the parameters set forth in the Board's capital regulations.

Those capital regulations are for all intents that my colleagues will quote from the general discussion that is

contained in the Board's capital regulations, where we stated: The Finance Board, however, would like to reiterate that while excess capital could be included in calculations for purposes of meeting regulatory capital requirements, it places an undue reliance upon excess stock -- undue reliance on excess stock to fulfill these capital requirements in a proposed Capital Plan may be viewed as inconsistent with the concept of excess stock.

The capital structure proposed in that Capital Plan may be viewed as sufficient by the Finance Board, requiring that all such actions by the Bank to address its capital structure shortcomings. It was, I think, in accord with that language that the capital sufficiency plan was adopted and was felt that it was appropriate for the Seattle and Atlanta Banks.

While, Mr. Chairman, you make the point that the staff has now put before us a resolution, which states that the Bank's approval of the Boston Plan, I think it is fair to note that this is a significant departure from what the staff had previously gotten, and I assume it was in accord with the instructions that you issued in Chairman II.

Why is this concern about excess capital and why, I must agree with statements that were made that we don't have to look at the source of the capital -- by having or permitting undue reliance on excess stock, we allow a Bank

to treat excess stock as if it were truly permanent stock. It is not. It is redeemable, as we know, by the notice.

The argument, which was made, and which you refer to, Mr. Chairman, that: Well, after five years, if the Bank is not meeting its regulatory capital, or its -- capital may be deemed to be impaired, you just don't go ahead and redeem.

If that happened, I think it would be a serious blow to that Bank and to the system to have stock, as to which there is a notice of redemption, which has matured and which the Bank is not in a position then to act on. I think that what we need to do is to carefully look at how the capital compositions of a Bank are put together.

I just want to refer to -- I think there are certain principles, which are important for safety and soundness and for the operation of this system. One is: Redeemable stock, which is not tied to assets on the Bank's balance sheet, should not be a significant source of required capital.

Obviously, we never want to see a situation where impairment is imminent and it should not be used as a substitute for a prudent capital regulation.

Secondly, a member nexus to activity has been a very important principle for the System. To the extent possible, we should retain the tradition of having a nexus between a member's capital and assets that are placed on the

Bank's books.

Thirdly, I am wary of creating a large investment class whose interests differ from the users of the system. That's what I mean when I talked about impairing the cooperative nature of the system. Because if you have a large investment class and their interests are tied primarily to the terms that they are going to get on their stocks, that could well be in conflict with those members of the system that uses, in the traditional sense, using it for advances.

I am also concerned that when you have a large investors class, you inevitable force the Bank to take on greater risks because to satisfy the dividend desires of that investor class requires greater profitability and greater profitability, as we know, leads Banks to take greater risks. I think that the Chicago model, which is in a sense embodied by the Boston Bank, also causes serious problems in commonality.

Commonality is important. Yes, we have distinctions among the Banks but we are still one system. I think that has such variations among the various Banks that you could mix, or rather induce some member arbitraging the system, to something that we should be careful, or very carefully avoid.

Mr. Chairman, I must say, I, unfortunately, must

disassociate myself with some of the remarks that you made. We do have some differences of opinion and I want to say, first of all, that I regret that in your statement there was no mention about the mission function of this Board. I think that is extremely important. We are not only a safety and soundness regulator; we are also the mission regulator. And not to have to any discussion of the great housing purposes, and economic development purposes, which this system performs, I think is unfortunate.

Obviously, you cannot be a mission regulator without having some awareness of, and some understanding of, the business plans of the Banks. If the business plan of the Bank is to create soap, obviously that is not one that we could countenance. I think to state, that you did, that we can't interfere with business decisions -- we are not interfering with the business decisions, when we perform our basic safety and soundness function in seeing whether a Capital Plan is one that is in accord with our capital regulations. I think that is our duty and function.

A Capital Plan is not just a business decision that any board can make. It is something that is inherent in the basic foundation for that board and for the System and one that has to be carefully scrutinized by us for safety and soundness.

I must say that, in some respects, it is almost

like Gramm-Leach-Bliley has been enacted since January 18, 2002 because we have a totally different reading of the statute between what we have in Chairman's Guidance I and the actual -- interpretation in Chairman Guidance II of April 23rd. Your comments today would seem to imply that Gramm-Leach-Bliley does not permit us to go beyond what are the leverage requirements set forth in Gramm-Leach-Bliley. I think that is a misreading of the statute.

I just want to refer to various provisions of the statute, which make it very clear that Gramm-Leach-Bliley saw the leverage requirement as a flaw and not as a ceiling and expected that the Finance Board would look at the capital plans to see whether safety and soundness were in accord with the overall standards and principles that the Board adopted, having in mind that the leverage requirement of Gramm-Leach-Bliley was a flaw.

It was that point that I wanted to refer to Section 6 at 12 U.S.C. 1426. In Section 8, the key language, and I am quoting: Each Federal Home Loan Bank shall maintain permanent capital in an amount that is sufficient and determined in accordance with regulations of the Finance Board. It goes on in that section later on -- When it talks about minimum capital, it says: The Board of Directors of each Bank are to determine the conditions of the operations of the Banks for the interests of its members

seeing that the needs, and I am quoting now, meet the minimum capital standards and requirements established under Subsection A and other regulations prescribed by the Finance Board.

Again, there is the same provision later on, where it speaks that: The capital structure of each Federal Home Loan Bank shall be composed of a board of directors of the Bank and at least an interim investment be required of each member of the Bank as necessary to ensure that the Bank remains in compliance with applicable minimum capital levels established by the Finance Board. Of course, this is the provision that I understand that prior members have asked the boards of the Banks to include in their Capital Plans.

I will just read it again: "...applicable minimum capital levels established by the Finance Board." So it is clear that we not only have the authority but I think that Gramm-Leach-Bliley made it clear that we have the obligation to ensure ourselves that the Capital Plans meet basic safety and soundness.

Let me just conclude by saying that I apologize for having taken a great deal of time. But I think we are dealing with very important issues; and, frankly, I wish that before Chairman Guidance II had been issued as final policy, that there was an opportunity for the Board to decide the issues that have now come before us in this way.

Because it is with great reluctance that I vote against a Capital Plan of a Bank and I want to express my appreciation to the President of the Boston Bank, Mike Jessee, who is most cooperative and which leads me to believe that this plan, without further ado at this time, that there could be a very easy resolution of some of the concerns that I have expressed.

I will urge that action because I think we are dealing with important principles; and by acting on this particular plan, we are going down a road that is going to be very hard for this Board to turn back on, or to modify. We already had just one radical departure. I don't think that it is going to be easy to have another. And before we decide that this is the path that we are going to take and that we are almost -- let me say, in accord with the statement you made today, so in limiting the safety and soundness role of this Board that I think that it would be most unfortunate and so I believe that we have the opportunity, we have the time. And we certainly have a means to make those modifications in the Boston Plan.

I just want to emphasize again that they are now changed so that we have neither an AMA requirement, although again I point out that the Boston Plan could begin with one but it has the opportunity to go to 0 when you don't have capital sufficiency. I don't know whether you need both an

AMA requirement in every instance to have capital sufficiency. Maybe that is like belts and suspenders. But to take off both the belts and suspenders means the pants are going to fall down. I think that this is not a plan that needs basic safety and soundness standards, as I understand it.

CHAIRMAN KORSMO: Before I return to -- I scarcely know where to start. And I do not want to respond to all that Director Leichter has raised, his view and his comments. I certainly do not want him to apologize for taking time. That is why we are here, to fully and completely discuss these issues.

Let me just make a couple of comments in response to what you have said and before I call on the other Directors to make their comments. First, let me say that, in anticipation, the housing mission of the Federal Home Loan Bank System is a given, so the fact that I did not mention it specifically in reference to the establishment of Capital Plans for given Banks certainly should not be read to imply that I do not take cognizance of the mission of the system as it was anticipated in the statute.

Secondly, let me see if I understand you right. You said that I was correct when I issued "Chairman's Guidance I". Your concern was that I was incorrect when I issued "Chairman's Guidance II" because it was not

consistent with "Chairman's Guidance I". Isn't that what I hear you saying?

DIRECTOR LEICHTER: Well, I think that what Chairman II has done, and as I said, whether you intended it or not, it has led Banks to believe that the door was being opened to make changes in their Capital Plans and the Banks could be much more lax in their safety and soundness standards.

CHAIRMAN KORSMO: Well, I would hope that no one would anticipate anything that was in that memo -- I guess I have to read it again to remind myself. But there was certainly no intent to suggest that there was any limiting of our concern about safety and soundness.

In fact, "Chairman Guidance II", from my way of thinking, was issued because it was quite the opposite of the way that you are approaching this. To my mind, in "Chairman Guidance I", I was incorrect and let me tell you why. Among the plans submitted by October 29th of last year, not a single one of them included any kind of *ad hoc* sufficiency test. The sufficiency test, frankly, came out of our staff processes in the wake of "Chairman's Guidance I".

The fact that is what happened led me to reassess that perhaps we were misguiding the staff when it came to dealing with the clear issues that are presented by Gramm-

Leach-Bliley and the statute, and our regulations. I have to interpret Gramm-Leach-Bliley to mean what it says, not what I would like it to say.

When it talks about the regs established by the Board, in terms of establishing capital standards, that regulation is in place. The capital sufficiency policy of a Federal Home Loan Bank is the minimum leverage and risk-based capital regulation that became effective last March 1st.

That policy was relied upon by the Banks in drafting and adopting their plans in good faith. That policy was relied upon by our staff in reviewing plans in good faith. It was relied upon by this Board in approving Seattle and Atlanta. I am loath to substitute my judgment in this case for what clearly has been established. I believe, in the statute and the regulation, which, admittedly was adopted by a previous Board.

I think Director O'Neill and you are the only current members, who were members of the Board when that regulation was adopted.

Frankly, at this juncture, I am not prepared to substitute my judgment for their action in that case. If we were inclined to do that, then we should revisit that regulation. If that is what the Board wants to do, I will be more than happy to do it. By the same token, I am

frankly not prepared to judge the impression that a Bank member may have. If, at some point, a Bank, down the road, has to say that because of the future activity anticipated in our business plan, we are not, at this time, prepared to redeem what is, in essence -- by definition, in fact, in the statute, permanent capital.

These plans were prepared by the management of the Banks. They were approved by the Boards of Directors of the Banks and -- from everything it seems to my knowledge -- they were vetted to the members of the Bank. To substitute their judgment, at this point, absent a legitimate concern about the safety and soundness standards, which are clear to me in the statutes and the regulations as they exist, I think is a mistake. That is, frankly, what I hoped to have mentioned in the course of my opening remarks.

I appreciate also your comment about whether or not we should consider the plan at this point. Well, the reality is the Bank has not asked us to withdraw the plan. And, short of that, certainly a Board member here could move to table or to postpone the consideration of the plan to some later date. But, frankly, I do not see any point in that at this juncture.

I would like -- maybe I am misunderstanding the nature of our current capital regulation. We certainly have called upon the lawyers, and our General Counsel on other

occasions, to suggest to us an appropriate meaning of that statute. I do not want to put them on the spot. Obviously, we have a disagreement, among certain members of the Board, as to what the meaning and intent of that regulation is. But, if you do not mind, I would call on the General Counsel and some of them in the General Counsel's office to maybe articulate in your mind how that regulation should be read.

MR. CROWLEY: Mr. Chairman, exactly which provision of the regs are you talking about?

CHAIRMAN KORSMO: I guess I am talking about the "capital sufficiency" provision. But, again, this was adopted as a portion of these regs by a previous Board on March 1, 2001.

Maybe before we do that, Director O'Neill would like to comment on the --

DIRECTOR O'NEILL: First, as the Chairman said, this was a magnificent presentation and there are so many parts of it, I only want to focus on one --

DIRECTOR LEICHTER: Did he say magnificent?

DIRECTOR O'NEILL: There is just one point and this goes to the -- I think it was called the sufficiency test, now called the sufficiency provision. I was here when we did the original regulation. To my mind, the problem with the sufficiency test, or the sufficiency provision, is that this was something that our staff did when it was

negotiating with the different Banks, especially with the Seattle Bank.

I guess what I want to say to you is: The Board never got involved at all in what became the sufficiency test, or the sufficiency provisions. Obviously, we have something in the regulation about that but that was a lot different than what the staff did and what became the sufficiency test, or the sufficiency provision.

So, when you talk about Chairman Chairman II, or I obviously that is just the Chairman. What I want to say, as a Board member, is that we, as a Board, never ever dealt with the sufficiency provision. What happened was when the Seattle Board and the Seattle Bank came to its conclusion of the negotiations with our staff, and everybody said: It's okay -- then, we came to a point where the staff and the Seattle Bank were in agreement.

My view is that the sufficiency test had never been run before the Board of Directors and that is why I think we are in the position that we are in right now because that was something that the staff did when dealing with the Banks. We, the Board, never got involved in that.

DIRECTOR LEICHTER: I have a problem with that. Tim, to the extent that we, as a Board, voted on it and we certainly were aware of it. We discussed it. I mean that you cannot say that we just went along with it because the

staff and the Banks were in agreement with it. We did it very consciously. I am sure that I can say that for you too, that you were aware of what was in the plan and we acted on it, so that is why I said that I think that we set policy. The Banks pursue -- (Static)

I just want to respond to something that you said, Mr. Chairman, when you said: Well, we now have this plan before us by the Boston Bank. A week before, they had a totally different plan, a plan that would have sailed through without certainly any comment on my part; and certainly not a critical comment because it had both the AMA requirement and it had the capital sufficiency.

So, the fact that the Boston Bank and our Directors decided on this plan is because of the invitation that was given to them by Chairman II, which may not have been intended. Therefore, I don't place any great deference on the fact that this is what the Boston Bank Directors want because a week before, they wanted something totally different.

CHAIRMAN KORSMO: Well, the reality is that it is before us today. We are in no position to guess otherwise on Boston's intent.

DIRECTOR O'NEILL: One final thing is: Obviously, when we had our Hearing, we brought in some people from the district Banks. When Norm Rice gave his testimony, he said:

If we went another way on the sufficiency test, he would be coming to us very quickly with an amendment to his plan.

As I said before, I think that it is necessary to get us to permanent capital, so I want us to be as quick to go on these as we could -- but anyway, I just think that this is one area where the Board did not really act, the staff did. And so to say that we, the Board, voted for the Seattle Plan and we were in favor of the sufficiency provision, I do not think that is true.

CHAIRMAN KORSMO: The other thing is that I would hope that this debate is not going to focus on "Chairman I" or "Chairman II" because the reality is that both "Chairman I" and "Chairman II" were separate and revocable policies, guidance statements. The fact is that the Board just adopted a plan by adopting the Pittsburgh Plan that contains neither an AMA requirement above 0 percent, or the sufficiency test.

So let us focus on the plan that is presented to us from Boston -- and probably move away on focusing on what later was or was not intended by either of the policy guidance statements, either of which could be replaced again at some point.

I do want to get back to calling on the General Counsel's Office, whether it is Tom Joseph or Neil Crowley. But before we do that, in the interest of -- because we do

conform with the Geneva Convention here, we are going to take a brief two-minute break to allow the inmates to escape to the restroom briefly and then we will come back. Let's convene again as quickly after 3:30 as possible.

DIRECTORS IN UNISON: Thank you Mr. Chairman.

CHAIRMAN KORSMO: My pleasure.

(Brief 5-minute break was taken.)

CHAIRMAN KORSMO: Before we took the break, there was discussion as to whether this plan is both legal and safe and sound. I am assuming that both statements came in the context of the statute, Gramm-Leach-Bliley, and also the capital sufficiency regulations adopted by the Federal Housing Finance Board on March 1st of last year.

That is by way of bringing us back to where I think we left off before the break. Let me call on Mr. Intrater to comment, if you would.

MR. INTRATER: Thank you, Mr. Chairman. Sometimes I don't think that break was a very good one. I was prepared to speak before that and now I have too many revolutionary thoughts.

Director Leichter let me digress for a minute about the mission issue because I just read part of a very good book by Tom Stanton, who is not a particularly good friend of the GSEs although he cares less for Freddie Mac and Fannie Mae than he does for the Federal Home Loan Bank

System.

We got lucky. You ought to be pleased by his reference to the Affordable Housing Program of the Federal Home Loan Bank system, which, he says, is the best of the Federal programs involved in the GSEs. So there is some recognition of the general elements of the mission of the Federal Home Bank System loans.

To try to answer the Chairman's question very directly. Neither the Pittsburgh Plan nor the Boston Plan, or the two plans, which preceded them; Seattle and Atlanta are inconsistent with the statute or inconsistent with our regulations. I usually defer to some of the staff because of their significant better knowledge of the regulations. They actually wrote most of them and also got stuck in the exercise of explaining them.

But we often get stuck in some of these discussions, particularly in the terminological morass aspects, which I think is unfortunate due to some of the statutory provisions. For example, when we talk about terms such as permanent capital stock, on a very real level, in terms of capital requirements, even so called excess stock is in a sense permanent, if it will be needed, to meet capital requirements Class B stock requires five years notice before it can be redeemed.

If we presume that the Bank’s boards are doing

their job, and to some extent we do presume that when the statute calls for them to provide for a Capital Plan that satisfies the needs of their members.

I know that five years is not an eternity but it is a significantly long time for them to take into account any changes that have to be made if a particular member is to leave. With regard to major examples of statutory safeguard, in addition to some that the Chairman mentioned in his opening statement, the Bank does not have to get involved in any further AMA transactions with a member who has determined that they are going to leave.

I just mention to you, as part of a context only, the Counsel's Office took a look at these plans. We looked at it from the point of view of whether the safety and soundness requirement is met and the general view of the Counsel's Office was that the requirement for safety and soundness is met by the Pittsburgh Plan, which you just approved; and by the Boston Plan, which you were discussing.

I will now ask Mr. Tom Josephs of OGC staff to add a comment based on a note he furnished to me earlier. Tom.

For the record, Tom Joseph actually does have a deaf ear. Tom you want to address something to the Meeting about the sufficiency requirements of Gramm-Leach-Bliley?

MR. JOSEPH: I think it should be noted or cleared up that the Boston Board of Directors never considered

putting into the eventual proposal the sufficiency language because the Boston Board of Directors considered a plan that was a little left over -- and it considered the plan that was submitted, which you are considering today.

But the versions in between those versions of the plan were done in draft and negotiated between the Pittsburgh Board staff and the Boston Board staff.

While I am sure that the Boston Board may be negotiating -- an expectation that would be approved by their Board of Directors, their Board of Directors never specifically considered that language, so you have to draw that distinction. The staff doesn't -- to go back to the -- most Board of Directors, each time they get a new version of the plan, we only do it when we think we have a version of the plan that everyone can live with, so it is important to realize that it be done well. I just thought that should be put on the record.

CHAIRMAN KORSMO: Tom and Arnie, thank you for your comments. Is there any other discussion of the Motion that is on the floor? Is there other discussion?

DIRECTOR MENDELOWITZ: Yes. Thank you, Mr. Chairman.

CHAIRMAN KORMSO: All right.

DIRECTOR MENDELOWITZ: I want to say thank you, Mr. Chairman. Like my friend and colleague, Franz, I am

also concerned about this plan, but for somewhat different reasons. I am not a lawyer, and Franz is a very good one, so I think I will leave the debate over the legal issues to the lawyers and move into somewhat different areas.

As I said earlier, in reaching conclusions about the safety and soundness of these Capital Plans, it is important that we recognize that we cannot look at a Bank's proposed Capital Plan as a stand-alone matter for consideration. Each Bank's plan must be considered in conjunction with, and be consistent with, that Bank's business plan, its risk-management systems and procedures, and its Board of Director's actions and policies.

Up until a couple of weeks ago, the Boston Bank had a proposed Capital Plan that I felt was consistent with its business plan and its risk-management procedures. Specifically, as regards the matter about which I have a concern, it provided for a range of capital charges for purchases of its members' mortgages, that is the activity-based capital charge for AMA purchases, which were between 3 and 6 percent. This range reflected the fact that the Boston Bank plans to impose an activity-based capital charge for AMA at conversion to the new Capital Plan of 4.5 percent.

Furthermore, it was consistent with the Bank's risk-management procedures. However, a week and a half ago,

the Boston Bank submitted a new, hastily-revised Capital Plan. To my knowledge, the Bank did not change its business plan, or its risk-management systems. Furthermore, the Bank did not change its plan to impose a 4.5 percent activity-based capital charge at conversion to the new Capital Plan. What it did do was to change the range in the plan for the activity-based AMA capital charge from 3 to 6 percent to 0 to 6 percent.

I inquired as to why this was done and was informed by the Boston Bank that it had made the change to maximize its flexibility going forward, so that if it changed it business plan and wanted to move to a 0 percent activity-based capital charge for AMA, it could do so without having to come back to the Finance Board for approval of any required changes to the Capital Plan and risk-management systems and procedures.

Maybe I am being overly strict in my duties, but I have a problem of agreeing to a Capital Plan designed to support an unformed, possible future business plan. This submission goes beyond the needs of the Bank in terms of its own current business plan and it is not consistent with the Bank's current risk-management procedures. I would have preferred to be presented with the Bank's original submission. It was safe and sound, and importantly, the AMA capital charge of 3 to 6 percent did not interfere in any

way with the Bank's ability to implement its business plan. On the contrary, it was perfectly consistent with it.

In your opening statement, Mr. Chairman, you said something that I agree with heartily. You said that AMA should not be arbitrarily taxed. Not only do I agree with that statement, I agree with the much broader statement that nothing that we do should be arbitrary. Everything that we do should have a good, rational, analytical base that we can explain to the world as to why we are doing it.

We are embarking on the first major changes to the structure of the Federal Home Loan Banks in their 70-year history. We are all trying to do our best as we work through these monumental changes, but there is no way that we can be sure that we are able to anticipate all the consequences of these changes as they unfold.

Like I said, perhaps, I am being too strict, but in this post-Enron world, I am reluctant to give a Federal Home Loan Bank a blank check as regards possible future changes.

If, at a later date, the Boston Bank's needs change, and its business plan and risk-management systems also change, and those changes require a change in the approved Capital Plan to implement them, then at that point, let them present a request for an amendment to the Finance Board, and let us deal with that request on the merits of

the case.

As I said, I don't believe that we should write a blank check to give the Bank the ability, going forward, to make significant changes to the whole interrelated system of risk-management policies and procedures, business plans, and Capital Plans that we are, in effect giving, *de facto* approval in the course of approving a Capital Plan.

Because of this, Mr. Chairman, reluctantly I cannot vote to approve the plan as currently submitted. I appreciate the hard work that the staff did; and I appreciate the recommendations that the staff made. But, at the end of the day, I cannot surrender my decision-making authority and responsibilities to the staff -- I cannot defend my decisions by saying the staff recommended it, so I did it.

For this reason, as I said, Mr. Chairman, I cannot vote in favor of this plan.

CHAIRMAN KORMSO: Thank you.

DIRECTOR MENDELOWITZ: As a final comment, it would probably be very easy to fix it in a way that does not interfere with the Bank's operations and makes me comfortable on safety and soundness grounds.

CHAIRMAN KORSMO: Nor should you surrender your judgment to the staff. I would be the last one to suggest that that is the case, which is why, when I felt like I had

surrendered my judgment to the staff in the wake of my first memo, I changed it. Let me just say that, as often happens, Director Mendelowitz and I completely agree on the facts and the circumstances in this situation.

But, as occasionally happens, we draw opposite conclusions. My reading of Gramm-Leach-Bliley is that it was intended to give Banks exactly what he suggests the Banks are asking for here and that is maximum flexibility to address changing conditions, so long as their actions are consistent with safety and soundness. In my reading of the statute and the regulations under which we operate, as they exist today, this plan is safe and sound and legal. I guess I said that before. I do not want to be redundant in that regard.

Arnie, did you have any further --

MR. INTRATER: I hope that we sound presumptuous, Director Mendelowitz. But in some of our briefings and some of our discussions, you start out this wonderful statement: I am not an attorney -- but those are questions of legal matters. So I am going to say something as follows: I am not an economist (laughter) but I just make two representations.

One is to remind the entire Board that, in addition to the approval of the Capital Plan, there are two other elements that have to be approved before a Bank goes

into implementation mode. One of them is the risk assessment procedures that are involved and that is still an ongoing process. The staff is working very hard to make sure that that composition is as sound as possible.

Of course, the risk model which also, as the Chairman noted in his Opening Statement, that certain elements ultimately of the safety and soundness of the substructure are before the Board. Those are my two representations.

DIRECTOR MENDELOWITZ: I appreciate the representations. The problem I have is that I am not talking about the model or running the model. That is a straight forward exercise; we know what we are doing; and what we are looking for. I am talking about a much more fundamental matter: How the balance sheet and the risk on the balance sheet is managed?

When you purchase AMA, if you have an activity-based capital charge associated with that, you remove the concern for that part of the balance sheet over a mismatch between maturity of your capital and the long-lived assets that you are putting on your balance sheet. As a result of that kind of activity-based fee, used to capitalize these extremely long-lived asset, you have taken a particular approach to managing that particular risk on the balance sheet.

So, when you have a circumstance in which the Boston Bank says: We are going to go forward; we are going to start out with a 4-1/2 percent activity-based charge for AMA purchases, that implies a certain approach to risk management. I have one set of expectations when that happens and I would be comfortable with a compatible set of risk-management structures and procedures.

If you plan to move forward with a 0 percent activity-based capital charge -- and I want to say very clearly, I have no position as a stand-alone matter whether you have to have activity-based AMA charges or not have activity-based AMA charges. I want to be careful and make sure that nobody misunderstands what I am saying here. If you put AMA on your balance sheet, you now have very long-lived assets on the balance sheet that present certain risks. If you do not have activity-based capital tied to it with a comparable maturity, then the result is that you have added risks and you have different risk management systems in place to manage mismatch between the maturity of the capital and the assets.

I would expect a Bank that does not have an activity-based capital charge for AMA purchases to come in and make the case for why they have the systems in place for managing that risk. I am open to being convinced on that and I am not opposed to it. If, however, you have a Bank

that starts out with the firm expectation that it is going to have a significant activity-based AMA capital charge, what they are telling us is that they have an entirely different approach to managing risk on their balance sheet than a Bank that does not plan to impose an activity-based AMA capital charge. Such an approach to risk management is not appropriate for a Capital Plan does not require an activity-based AMA capital charge.

That is why I feel that a 3 to 6 percent activity-based capital charge is a good range for the Boston Bank's Capital Plan. And, importantly, it does not interfere with the Bank's current business plan. I think, Mr. Chairman, you were quite articulate and quite correct when you said that it is the responsibility of the Boards of Directors of these Banks to set their business plans. It is our responsibility to make sure that, after they set the business plans, they are safe and sound in their operations and they comport with their mission responsibility.

So, as I explained, a range from 3 to 6 percent does not interfere at all with the Bank's business plans. The only thing that it does is that it brings the Capital Plan into conformity with the reality of how they plan to manage the risk on their balance sheet. And should they depart from their current approach to management risk, basically, we have to tell them that they have to come in

and explain to us what the new risk management procedures are and what they are doing to insure safe and sound operations.

CHAIRMAN KORSMO: Which, of course, is exactly right, which is why we left the approval process for the risk management and processes to the staff because they change on an ongoing basis. I think we had this discussion earlier in the process about whether or not the Board specifically would approve risk-management procedures and controls.

We concluded that would be problematic because they would have to be coming back constantly for Board action. So that is why we left the approval of those processes and the oversight of those processes on an ongoing basis to the staff --

DIRECTOR MENDELOWITZ: Mr. Chairman, I think you are quite correct and I agree with that. The kind of changes that we are talking about that the staff should be on top of are marginal changes. The concern that I am putting on the table relates to fundamental risk management issues. It is the difference in the approach to managing risk, when you have one type of balance sheet and how you capitalize it versus another type of balance sheet which is capitalized differently.

CHAIRMAN KORSMO: I do not think there is any

argument. I would not argue with that other than to say that, as a Board, we are not going to be doing that for them. Yes, Jim?

MR. BOTHWELL: I would like to add that the Gramm-Leach-Bliley Act is very clear that each of the Capital Plans has a provision that the Bank's board of directors has imposed upon itself a continuing obligation to monitor, adhere and adjust, if necessary, its required members' investment to ensure that the Bank is always in compliance with its minimum capital requirements. This is why I mentioned that the approval resolution required an amending of the plan.

So this is, indeed, I think a very important responsibility that Gramm-Leach-Bliley has given the Boards of Directors of each of the Banks -- to manage their capital accounts to ensure that they have appropriate capital to support the risks on their balance sheets. I do not believe that it is providing any Bank with a blank check if the Board approves these plans.

I have already instructed the Office of Supervision to make sure that each examination determines whether the Board of Directors of that Bank is given the information it needs about its capital account structure -- How much is required capital? How much of the stock is held in excess of the required amount? How much is retained

earnings? and any other loss-absorbing source of capital that the Board may approve in the future -- to ensure that the Banks' Boards are making informed judgments about just that issue.

So this is something that the Finance Board can do -- the very fact that we are monitoring to make sure that the Boards of Directors of the Banks are actually managing their capital accounts.

So you are quite correct when you say that it is a big responsibility that has been placed on the Banks -- in going forward again, we want to make sure that is a component of our examinations, and, of course, we monitor monthly the capital positions of all the Banks as well.

CHAIRMAN KORSMO: Director Weicher has had his hand up for a long time.

DIRECTOR WEICHER: No. That is perfectly fine, Mr. Chairman. It was an ongoing discussion between members of the staff and members of the Board. There is no reason for me to cut in on that because I want to raise what is actually a little different question on this. I will start by saying that whatever I say I am not a lawyer, but if General Counsel starts to laugh, then --

Sometimes I think that when I leave this job I will read for the law and see if I have another career. I have to make a decent living.

I want to go back to the question I asked twice now. I will ask it again in a little different way and make sure that I have it right: My understanding is that both the staff and the Bank -- both our staff and the Bank's staff have conducted stress tests of the Capital Plan under a variety of scenarios.

I see that Austin has given up and left on us.

There is also my understanding that the Bank, at least, has conducted a sensitivity analysis of what will happen if they expand their activities, either their AMA activities or their advances beyond the current level if there are substantial expansions of activities; and if there is not a problem with meeting the capital standards over the stress test in most circumstances.

Am I correct on this? Do I have a correct understanding of this?

MR. SMITH: If the final analyses do include capitalization on a stock, it would be fair under the stress scenario.

DIRECTOR WEICHER: What would happen if they chose to expand their activities in either direction, either in advances or AMAs? What would that do to their ability to meet the stress tests and both the statutory capital standards and the regulatory standards, I believe which we have established for the stress test under the statute.

MR. SMITH: Yes.

DIRECTOR WEICHER: I got that right? Okay. To my mind as a non-lawyer, but as an economist, I do think that is the central issue, certainly the central issue that concerns me as a member of the Board. I do not want to leave the impression, which I may have done inadvertently earlier, that I was not concerned about where the capital came from but I am very concerned about what the capital is and what the capital is for. If it is there for when it is needed, then I think this work is -- these are the issues that motivate me to make a decision.

MR. INTRATER: Can I just ask for a clarification of what Dr. Weicher's question was. Is the stress test conducted in view of the amended Boston Plan where there could be a zero AMA requirement?

CHAIRMAN KORSMO: Let me ask you, Austin.

MR. KELLY: No. Especially -- specifically, if the plan is definitely subject to -- the stress test that we have is probably closer to -- (too far from a microphone)

DIRECTOR LEICHTER: I'm sorry, as 4.5? So that you made no stress test to go with -- just a lower AMA test to 0?

MR. KELLY: That is correct.

DIRECTOR WEICHER: Did not the Bank conduct a sensitivity analysis on that scenario? It is my

understanding that that is what it did.

MR. SMITH: Wasn't this the case where they had 0 perhaps?

MR. KELLY: In a base line scenario?

MR. SMITH: That's right. We think it was maybe inadvertently put it in there because the volume was very low.

DIRECTOR MENDELOWITZ: It increased my confidence level.

CHAIRMAN KORSMO: Go ahead.

MR. SMITH: I just want to say that they did, in fact, the day after the sensitivity analysis, allowing for the expansion of AMA activities with a 0 stock-purchase requirement against AMA activity.

MR. KELLY: There is one scenario that Boston gave us that has AMA standards to about $2 billion?

DIRECTOR WEICHER: About $5 billion.

MR. KELLY: About $2 billion based on that scenario, I think.

DIRECTOR WEICHER: For stress?

MR. KELLY: Yes.

DIRECTOR WEICHER: Then it is clear that they are quite a bit smaller than --

MR. SMITH: It's .2.

DIRECTOR WEICHER: I will try to remember that

because that is why -- and I am concerned that the Bank, for some reason, has passed the stress test that the Board has established.

DIRECTOR LEICHTER: And this was done on a 0 AMA requirement?

MR. KELLY: This was done on a 0 AMA requirement.

DIRECTOR LEICHTER: But not tested by house staff?

MR. KELLY: No. Our test was based on their starting values. There are broad ranges for the membership and advances and in the stock purchase requirements for AMA. If you start playing games, adjusting them all down to 0, you can end up with too little stock.

CHAIRMAN KORSMO: Is that because we used the same system?

MR. SMITH: No. Our test was based on their -- clear -- starting values. There are broad ranges for the membership advances in the stock purchase requirement for AMA. If you start playing games about garnering them all down to 0, you can --

DIRECTOR MENDELOWITZ: That is not a rational expectation, so it is hard to know how to juggle that. Mr. Chairman, I would like to quote President Reagan, who --

CHAIRMAN KORSMO: Your favorite President.

DIRECTOR MENDELOWITZ: All that I can say is that I like some of his great quotes. One of my favorites is

when he was talking about dealing with the Soviets: "Trust but verify". I appreciate all of Jim's good words.

If, in fact, the world were a perfect world, you would not need an examination staff or a Finance Board, because once you give responsibility to a Board of Directors, they would do it correctly. However, nobody thinks the world is perfect, so we don't rely solely on a Board of Directors. I have said since the day I got here that I view a Board of Directors as the first line of defense of a safe and sound system.

However, we don't rely solely on them because we know the world is not perfect.

If the world were a semi-perfect world, we could have an examination staff and no Finance Board. And we could rely on the examiners to get involved and make sure that everything were done correctly.

However, we live in an imperfect world; and, in this imperfect world, we have sorts of checks and balances, and all sorts of belts and suspenders to make sure that a system with a $700 billion balance sheet, and which has a hook into the Treasury, and is perceived by the investment community as being an entity whose debt, in effect, has some kind of perceived guarantees from the Federal government, is managed safely and soundly.

There are responsibilities placed on the Boards of

Directors. We have the regulations; we have the examiners, and we have the Finance Board itself.

My feeling is that going forward, if we can find a way to reduce the risk that something could go wrong, without unduly burdening a Bank or its business plans, we should not reject that out of hand. There is no reason for this Bank, based upon its business plan, to have anything in its approved Capital Plan that permits it to go to a 0 percent activity-based AMA capital charge. I think this is something fairly easy that we can grasp today and work together and fix because it is not a major problem. It does not impinge on the Bank; it does not adversely affect anyone. But what it does increase, at least, is my level of confidence with the safety and soundness of the plan.

CHAIRMAN KORSMO: Any other comments or discussion?

DIRECTOR WEICHER: I do believe in trust but verified. I look at the verifiers as being the staff of the Board. You guys are the keepers of the verified and I trust you -- I don't have to give my judgment to you, but I trust you to do the analysis. I am satisfied with what I have heard from you this afternoon.

CHAIRMAN KORSMO: Is there any other discussion?

DIRECTOR MENDELOWITZ: Yes. One last observation on the stress test.

CHAIRMAN KORSMO: Yes.

DIRECTOR MENDELOWITZ: That is a very low standard in the sense that the stress test and analysis that you do is something to raise confidence that we are moving in the right direction. It is not a substitute for having in place the appropriate boundaries and restrictions that ensure a safe and sound plan.

CHAIRMAN KORSMO: Is there any discussion?

DIRECTOR LEICHTER: I have one 30 second comment that I wish to make. Let me first preface it by saying that I think we have had a good discussion and I hope we have more of these deliberations because I think they are very, very helpful. I want to thank you for a very open and cordial meeting that you ran throughout and that you encouraged us to enter into this discussion.

I just want to say two things. One, the point was made that while we passed the Pittsburgh Plan, it did not have the AMA or capital sufficiency for which I expressed concern. I just now want to point out that that is why we got the resolution of the Executive Committee of the Board of Directors, saying they would adhere to the capital sufficiency requirement. So Pittsburgh satisfies me but Boston doesn't.

Finally, I don't want to leave the impression that I am in any way not supportive of AMA. I am very supportive

and I think we can have AMA programs, and very robust AMA programs, but still provide a capital structure and a connection between capital and the risks that are placed on the books of the Banks to not raise any safety and soundness concerns and which will keep what I think has been a very healthful and a very productive tradition of the Home Loan Bank system.

CHAIRMAN KORSMO: Any other comments? I am almost reluctant to make that statement.

Are there any other comments? Hearing none, we have before us a Motion to approve the two resolutions: one which would approve the capital special plan of the Federal Home Loan Bank of Boston; and the second resolution, which would approve the resolution involving the financial management policy exemption.

Just so we are all clear on this, there is a condition embedded in the first resolution and, Jim, just so all of us understand it before we vote on it, would you state what that is.

MR. BOTHWELL: Yes. It would be the continuing obligation on the Board of Directors of the Boston Bank to review and make any adjusts to its required members' investment, as is necessary, to ensure that the Bank meets all regulatory capital requirements, as required under Gramm-Leach-Bliley and the regulations.

CHAIRMAN KORSMO: Thank you. That is the Motion. You have all heard the Motion. The Secretary will please call the roll.

THE SECRETARY: On the Motion before the Board now, Chairman Korsmo, how do you vote?

CHAIRMAN KORSMO: Aye.

THE SECRETARY: Director O'Neill?

DIRECTOR O'Neill: Aye.

THE SECRETARY: Director Weicher?

DIRECTOR WEICHER: Aye.

THE SECRETARY: Director Mendelowitz?

DIRECTOR MENDELOWITZ: Nay.

THE SECRETARY: Director Leichter?

DIRECTOR LEICHTER: Nay.

CHAIRMAN KORSMO: The Motion is carried. The Resolution is approved.

Thank you all. I, too, think that it was a very valuable exchange and I think it will be helpful as we move forward with the balance of the plans. As we learned, as regards to each one of us, there has been an aspect of it that has led to improving the plans as we go along. Recognizing it as an imperfect system, we are also an imperfect Board. As Director Mendelowitz anticipates of the Banks, we are also having challenges put before us and so the question arises: Then who is watching us?

I think that the question raises an important point. As you heard today and, in fact, have heard many times before, I am intent, as Chairman, on reaffirming the Board's role in ensuring the safety and soundness of the Home Loan Bank System. The chief way that the Board can accomplish that duty, I believe is to follow Gramm-Leach-Bliley and not involve itself beyond what is anticipated in the statute as the decisions of each Board's Banking executives and Boards of directors.

I think that today's votes are representative of an important statement of that philosophy. Once the safety and soundness of the two Capital Plans were guaranteed, as I believe they were, it was not, to my mind, the Board's role to interfere further in the Bank's business and operations. Again, I understand that there are different perspectives on that among my fellow Board members. I respect those differences.

In my months as Chairman, I have given great thought as to how we can demonstrate on an ongoing basis our commitment to the bright red line of separation between the Board and the system, recognizing always, of course, that we are responsible not to the System but, indeed, as we heard in a briefing not too long ago: We are not stewards of the Banks, we are stewards of the taxpayers.

As you heard me say on any number of times, for

example, I believe that it is inappropriate for a member of this Board to be present when a Bank's Board of Directors discuss decisions that may eventually come before us as a regulator. As regulators, we must always be cognizant of the powers we possess and sometimes that is a little frightening to me.

As a result of recognizing that, I think once we complete our analysis on the eight remaining Capital Plans, I will be asking the Board to consider and to adopt a standard of conduct for Finance Board staff and Directors that codifies the bright red line between the regulator and the regulated. Both the 1998 GAO Study and Gramm-Leach-Bliley have implored us to keep an arms' length relationship with the Bank System. I would suggest that it is difficult for a regulator to keep an arms' length relationship when we are repeatedly elbow-to-elbow with the regulated.

So, over the next two weeks, I would ask you all to consider what elements we might want to go in a Code. I hope to bring a plan to the Board in August and I will say that, frankly, in the meantime, I expect we will be having some continued discussions on what I would think appropriate for inclusion.

I look forward to that and I think this might be an issue we can take up in our housekeeping sessions. If not, we may have to find a format that will allow us to do

that.

With that, we have concluded the Agenda business. Are there any other items to come before the Board?

DIRECTOR O'NEILL: I have one. Since we are talking about Capital Plans today, I think I speak for other Board members, other than you, Mr. Chairman, in saying how pleased we are that you and Michelle Larson will be tying the knot on May 17th.

In Arnie Intrater's words: That is a Capital Plan indeed.

CHAIRMAN KORSMO: Thank you. I appreciated that.

DIRECTOR LEICHTER: I just want to add: I think it is safe and sound.

CHAIRMAN KORSMO: That may be premature --

(Whereupon, at 4:15 p.m., the Public Meeting of the Federal Housing Finance Board was adjourned.)

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REPORTER'S CERTIFICATE

CASE TITLE: FEDERAL HOUSING FINANCE BOARD - PUBLIC MEETING

MEETING DATE: MAY 8, 2002

LOCATION: WASHINGTON, D.C.

I hereby certify that the proceedings, above described, are contained fully and accurately on the tapes and notes reported by me at the Public Meeting in the above matter.

Date: May 8, 2002

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